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INTRODUCTION

Child Care Network (CCN) entered into contract number 4C-02-81001-2 with the Michigan Family Independence Agency (FIA) to provide child care referral, child care resource coordination, recruitment, and provider support, outreach, and Project Zero child care specialist services. CCN was reimbursed for actual costs incurred for providing these services, through submission of monthly billings to FIA. The original contract totaled \$453,668, and covered the period October 1, 2002 through September 30, 2003. Contract number 4C-02-81001-2 was extended to cover the period October 1, 2003 through September 30, 2004, for an additional \$453,668.

SCOPE

The Office of Internal Audit performed an audit of Child Care Network to determine if the agency's billings were accurate, and if costs billed were allowable and properly supported by the accounting records and other relevant documentation, in accordance with the terms of the contract. Our audit covered the period October 1, 2002 through February 29, 2004. Our audit was performed in accordance with Standards for the Professional Practice of Internal Auditing, issued by the Institute of Internal Auditors, except that compliance with Standards 2200, Engagement Planning, and 2300, Performing the Engagement, were limited as follows: Consideration of significant risks to the activity and adequacy and effectiveness of activity's risk management and control systems was limited to those relevant to performance of duties related to Child Care Network's contract with FIA and those relevant to documenting the expenses billed to FIA. We did not consider significant risks and adequacy and effectiveness of the risk management and controls systems of Child Care Network's entire operation.

EXECUTIVE SUMMARY

Based on our audit, we conclude that Child Care Network did not use an acceptable method of allocation for charging fringe benefit costs to FIA. The total amount overbilled as a result was \$21,043.91 for FY 2003 and \$8,031.29 for FY 2004. Our report recommends that the FIA Adult and Family Services Administration initiate the process to recoup \$21,043.91 from Child Care Network, and ensure that Child Care Network adjusts its billings for FY 2004 to properly bill for fringe benefits for that fiscal year. In addition, we noted that Child Care Network's timekeeping procedures need improvement in order to fully comply with federal regulations for billing salaries and wages to federal programs.

CHILD CARE NETWORK RESPONSE

Child Care Network requested that a significant portion of its response and a letter prepared by its CPA firm be included in this report. Therefore, we have included those two items at the end of this report.

FINDINGS AND RECOMMENDATIONS

Salaries

1. CCN did not properly document employees' time and activity for each of the contracts per federal requirements. Federal Office of Management and Budget (OMB) Circular A-122, *Cost Principles for Non-Profit Organizations*, states in part "Reports reflecting the distribution of activity of each employee must be maintained for all staff members (professional and non-professional) whose compensation is charged, in whole or in part, directly to awards....The reports must reflect an *after the fact* determination of the actual activity of each employee. Budget estimates (i.e., estimates determined before the services are performed) do not qualify as support for

charges to awards. Each report must account for the total activity for which employees are compensated and which is required in fulfillment of their obligations to the organization.

All Child Care Network employees prepared time sheets that documented the programs they worked on each day. However, they did not record the number of hours worked on each program, and charges to each program were based on the budget prepared at the beginning of the year. Child Care Network had adequate documentation that their employees performed the services required by the contract, and the amounts charged for each employee appeared reasonable. Therefore, we are not recommending recoupment of any amounts CCN billed for salaries.

WE RECOMMEND the Adult and Children's Services Administration ensure that Child Care Network implements timekeeping procedures to comply with OMB Circular A-122.

Fringe Benefits

2. CCN did not have a reasonable method of allocating fringe benefits to the various programs. The cost of fringe benefits for each employee were charged to one of the programs the employee worked on, usually the program they worked on the most. As a result, we determined that CCN overbilled FIA \$21,043.91 for fringe benefits for FY 2003 (\$9,944.49 for 4C and \$11,099.42 for Project Zero (PZ)). In addition, we determined that CCN overbilled FIA \$8,031.29 for FY 2004 through February of 2004 (\$3,335.47 for 4C and \$4,686.82 for PZ). We based our audited figures for fringe benefits on the percentage of salaries charged to FIA.

WE RECOMMEND the Adult and Family Services Administration initiate the process to recoup \$21,043.91 from Child Care Network for overbilling on the FY 2003 contract.

WE FURTHER RECOMMEND that the Adult and Family Services Administration ensure that Child Care Network adjusts its billings to correct for the amount overbilled from October 2003 through February 2004.

CHILD CARE NETWORK RESPONSE

Page 2 of the Child Care Network's response to our draft report follows:

"Steps taken to Correct Benefit Allocations and Improve Grant Time Tracking"

1. We have developed spreadsheets to use for each fringe benefit to keep premium payments on track with payroll splits. We implemented this system on 5-17-04. Please see attached benefit premium bills for examples.
2. CCN is purchasing TimeCentre, a web based fund tracking program, that can feed direct and indirect service time logged into our payroll system directly. These splits will then be used to adjust the Excel benefit template and each premium for each staff member will be split accordingly. We are currently using a grant time tracking form that staff fills out by hand and are using manual calculations to adjust grant charges.
3. We have increased our Accounting position to 30 hours per week and increased the qualifications for the position to a Bachelor's in Finance, Accounting or Related field and at least five years of experience. Accountant and Executive Director will attend a seminar in the latest IRS and Federal Grant regulations annually.

In closing, Child Care Network has worked very hard to keep accurate records. As you know, all other records were in order and were very detailed. Please take into account the following points:

- All FIA and PZ money budgeted for fringe benefits was spent on fringe benefits for people working on those services. No money was erroneously used for staff members not funded by FIA or PZ.
- All work expected to be done by CCN for both grants was delivered. There was no lack of effort, quality or results. Objectives of the grants were met and the State of Michigan received the services it paid for.

- Child Care Network's spending on fringe benefits did not exceed the budgeted line items for fringe benefits. Charges were reasonable and appropriate in this light. All billings, with back up detail, were approved by the Office of Management and Budgets on a monthly basis.
- The detail required by FIA on fringe benefit allocations has never been cited by our independent auditors who are well aware of A-122 guidelines. Child Care Network has on this issue with its' auditing firm, ..., which is a reputable, licensed firm with many years of experience. Their interpretation of A-122 is different from FIA's interpretation. Their letter will follow under separate cover.
- Since A-122 is relatively new under A-133, Child Care Network maintains that FIA has a responsibility to instruct its' sub-contractors on acceptable practices and changes in Federal regulations that could affect audit results.

Given these many issues, Child Care Network's excellent services and long standing fiscal responsibility, we hope that FIA will reduce these findings to be recommendations for changes in our fringe benefit tracking. As you can see, we have taken several steps to address this issue and have indeed already corrected it.

I thank you for your assistance in helping us to address these audit findings, and for your great willingness to answer questions. As you know, the 4C Directors will gather on June 11 with ...to further clarify FIA's expectations on grant fund tracking. We will make every effort to comply with regulations and appreciate the outreach to help us. We hope, though, that we can establish a pattern of training on specific regulations before audits are conducted to assure compliance with those regulations.

Please let me know if you need further information from CCN to support the statements made in this report."

LETTER FROM CHILD CARE NETWORK'S CPA FIRM

The body of the letter from the Child Care Network's CPA firm follows:

"This letter is being written in response to a request from Jennie McAlpine, Executive Director of Child Care Network. Child Care Network charges fringe benefits to grant programs based on the Simplified Allocation Method as detailed in Circular No. A-122.

As I am sure you are aware, the Simplified Allocation Method allows an organization to allocate indirect costs by dividing the indirect costs by an equitable distribution base. The Child Care Network uses the simplified allocation method for fringe benefits by dividing total fringe benefit expense (the indirect cost) by total wage expense (equitable distribution base). The resulting rate for fringe benefit allocation is then multiplied by the amount of wages specifically expended on a particular program which results in the amount of fringe benefits charged to the grant.

Recent discussions with Jennie McAlpine have indicated that Child Care Network has put into place the procedures necessary to track fringe benefits on an actual expense basis for

each grant. However, since Child Care Network has followed the Simplified Allocation Method as detailed in and permitted by Circular No. A-122, we feel the Organization should not be penalized for not charging past indirect grant expenses on an actual expense method.

Thank-you for your attention to this matter.”